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# Investment philosophy – maximising returns or minimising risk?

**Tim Farrelly**
Principal
farrelly's Investment Strategy

# Maximising returns or minimising risk?

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- What is your philosophy?
- Lifecyle investing philosophy
- Are your processes consistent with your philosophy?
- How this impacts risk profiling
- How to tidy up your processes – if necessary

# What is your philosophy?

- Maximise returns?
- Minimise risk?

# What risk are we minimising?

- Volatility?
- Risk of loss?
- Risk of not meeting goals?
- Risk of being fired?
- Risk of being sued?

# How do we do risk profiling today?

- What's the process?
- What are the tools you use?
- What is the aim of the exercise?

# Client friendly?

What is even more ironic, however, is that once we supposedly identify an investor's tolerance for risk, we then endeavor to position them TOEXPERIENCE IT! This is like identifying that a person can "tolerate" a second-degree burn and then proceeding to place their hand in a fire long enough to achieve it. Oh, by the way, in your attempt to achieve a second-degree burn there is a 33% chance that you will achieve a third-degree burn...so don't try this at home.

*David Loeper*

# … and defensible?

Assessing the adequacy of risk profiling practices is likely to include a consideration of whether the FSP has:

- Addressed the limitations in the risk profiling tool used;
- Addressed both the client's attitude to risk and capacity for loss;
- Determined the risk profile for each spouse or partner;
- Determined the risk profile of the client in each of the capacities the client acts
- Conducted a transparent risk / reward trade off
- Sought to actively understand their clients' concerns and objectives; and,
- sought to educate their clients about risk and reward.

FOS's on risk profiling practices (Aug 2011)

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# Lifecycle investing

- Differentiate between psychological risk profile and financial risk capacity?
- Aim is to maximize the chance of meeting goals

# What drives an investor's risk profile?

- Financial risk capacity-what Minimum outcomes must they have?
- Psychological risk tolerance-How much Pain can they handle along the way?

# Risk capacity and retirement

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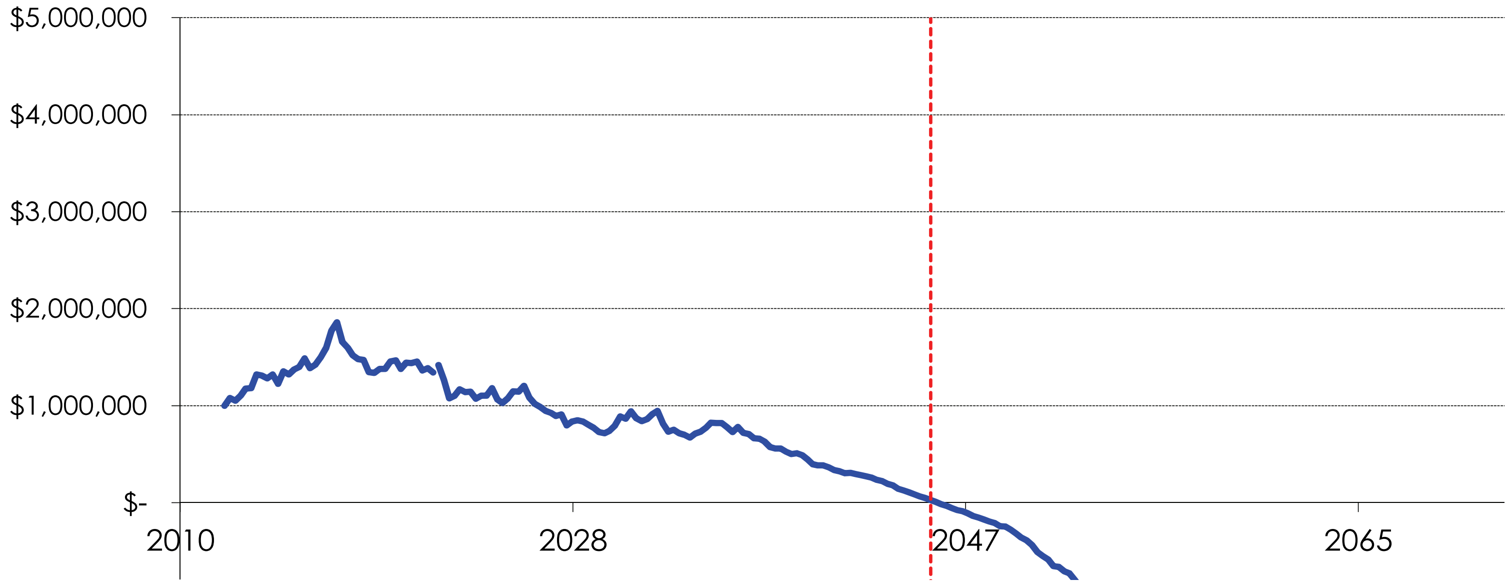
- Single investor aged 60, retires at 65, life expectancy 93
- Client has $1,000,000 in super
- Owns home unencumbered
- Wants to spend $100,000pa
- Earns $150,000 after tax, saves $50,000pa
- Risk attitude 70% risky assets
- What is this clients Risk Capacity? 30%, 55%, 70%, 90% risky assets?

# Current strategy is ok if equities perform well

Real capital balance over time, 70% risky assets, 100k spend.

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# What is the likely range of outcomes?

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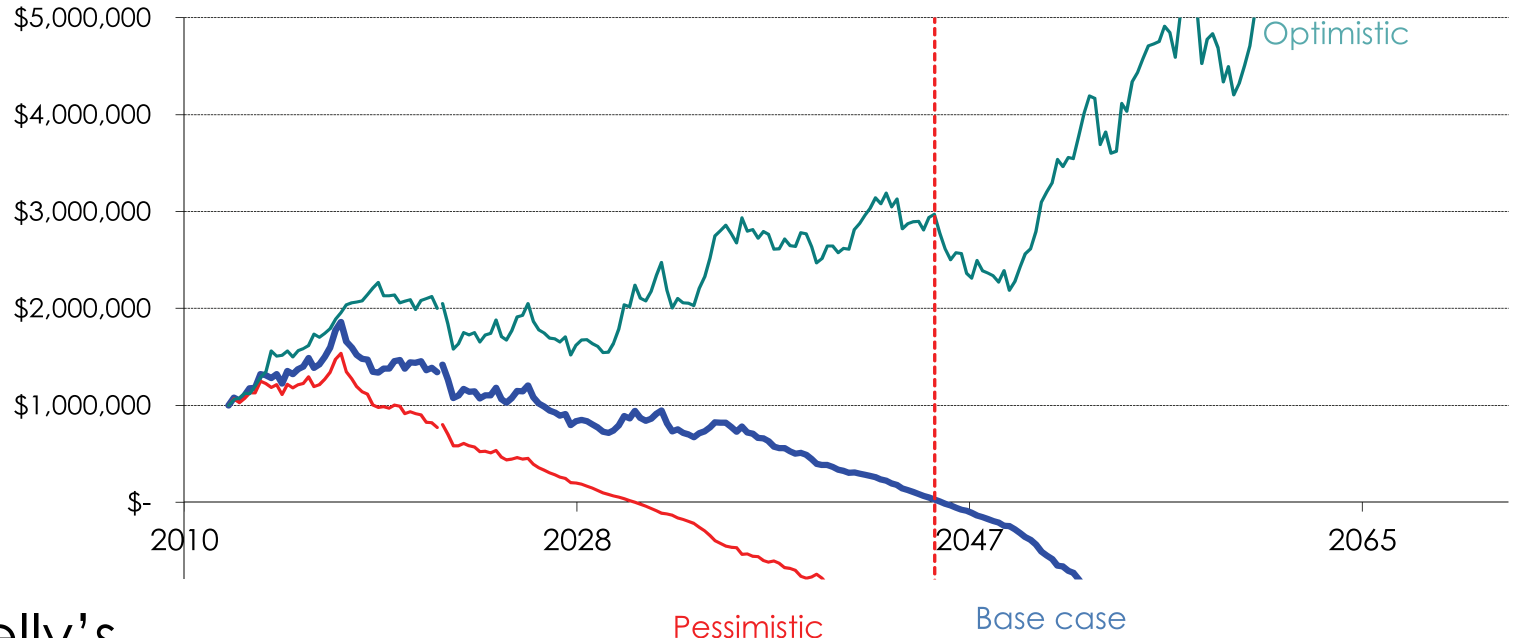
Real capital balance over time, 70% risky assets, 100k spend.

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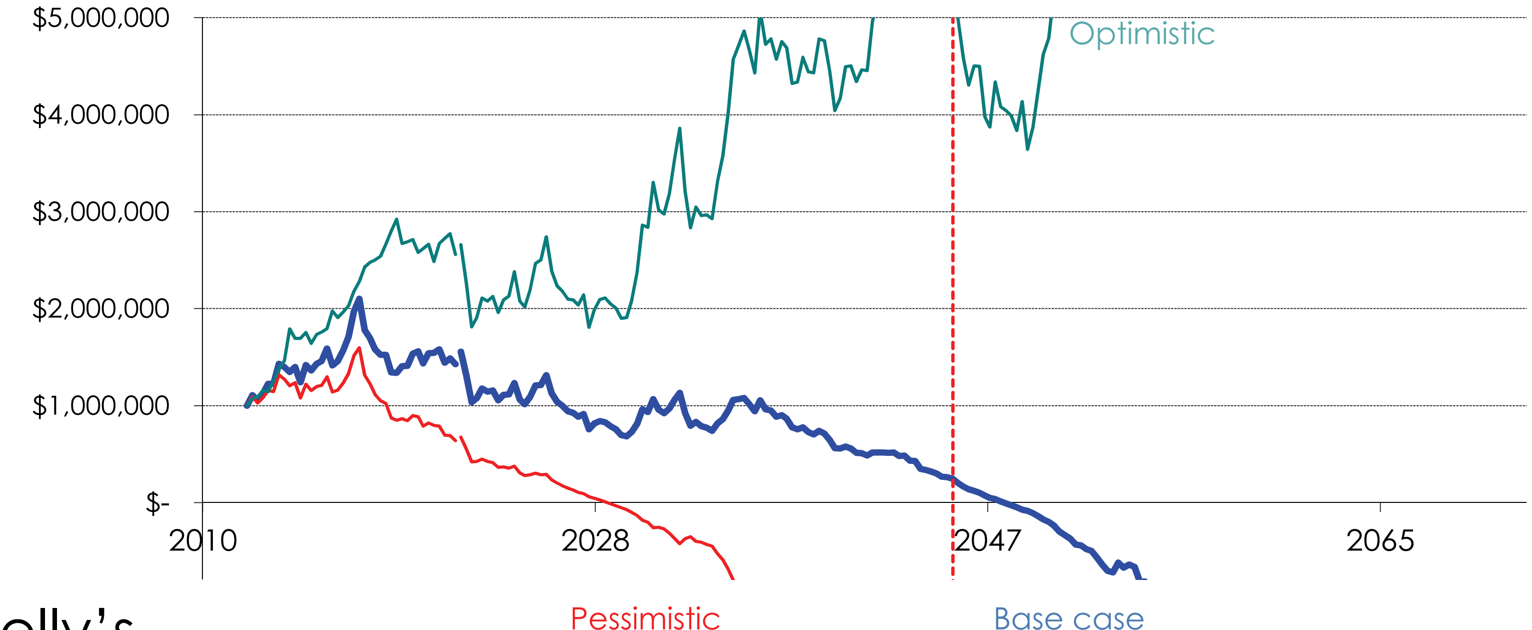
# Should we take more risk?

Real capital balance over time, 90% risky assets, 100k spend.

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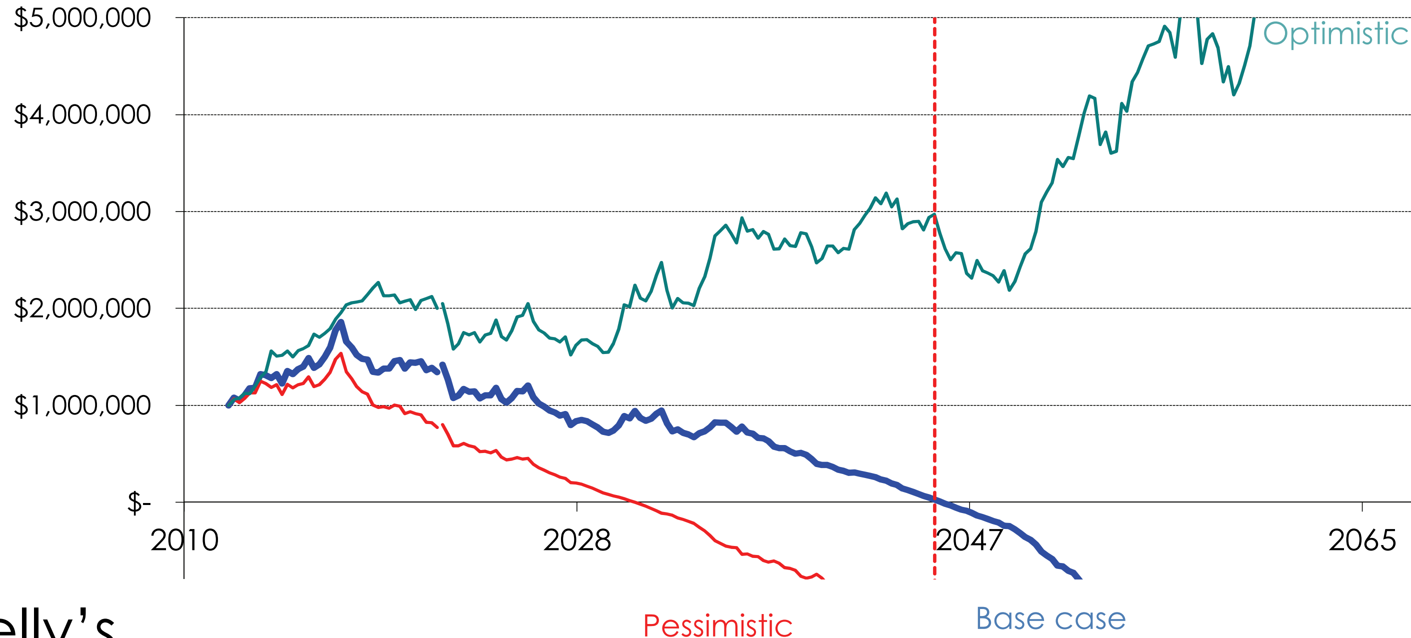
# The same?

Real capital balance over time, 70% risky assets, 100k spend.

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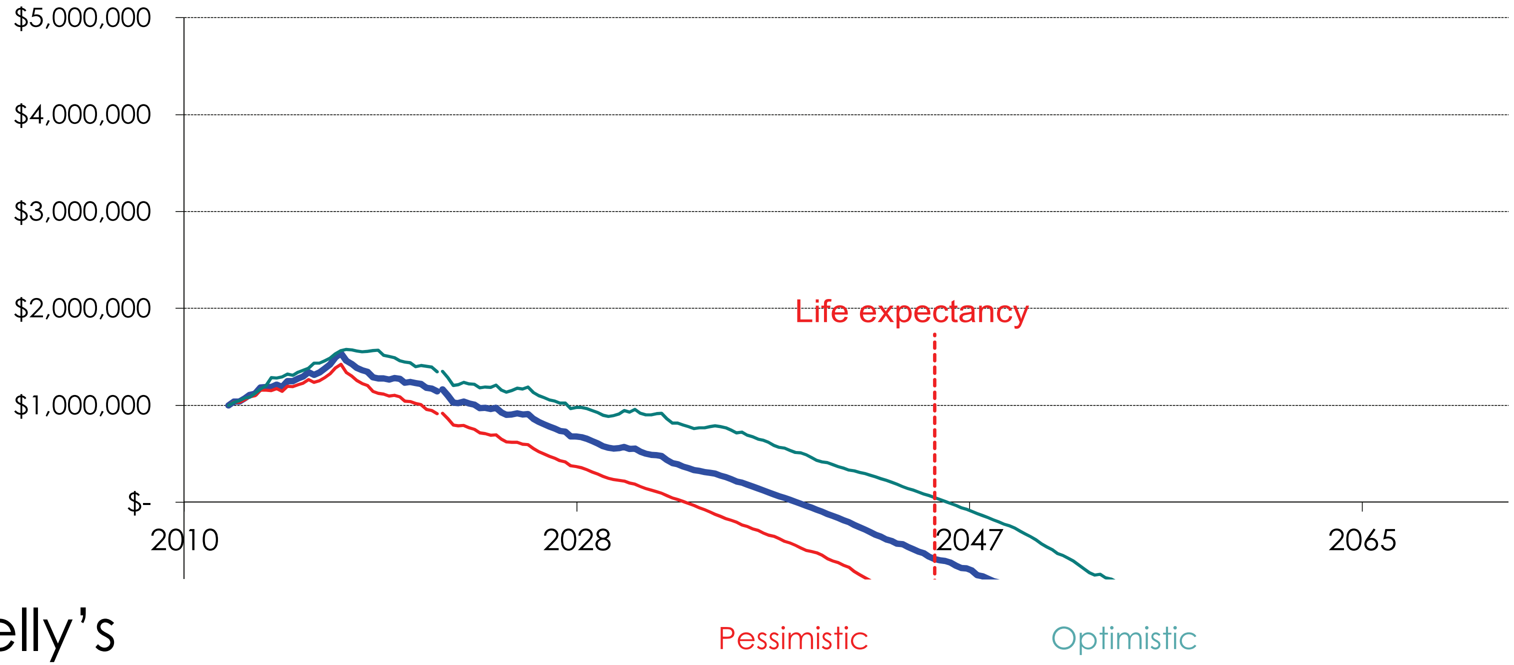
# Or less risk?

Real capital balance over time, 30% risky assets, 100k spend.

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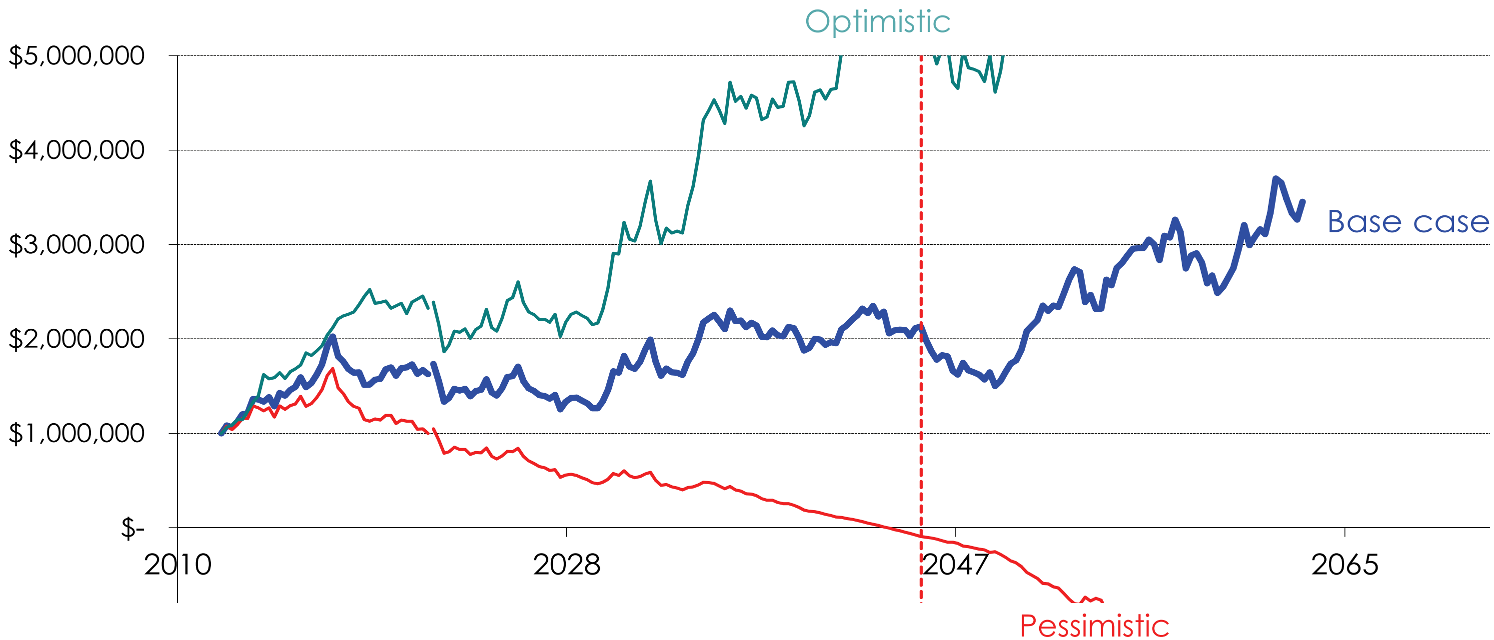
# Just has to spend less

Real capital balance over time, 70% risky assets, 75k spend.

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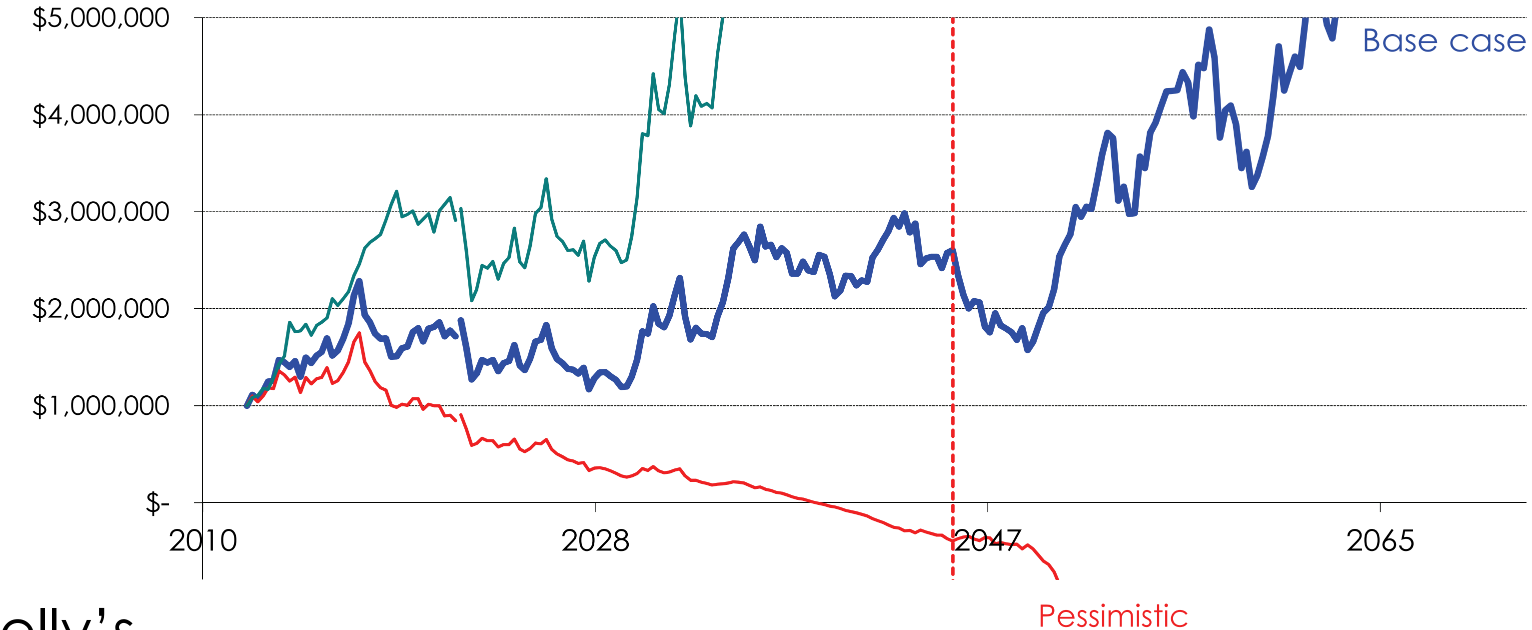
# Take more risk?

Real capital balance over time, 90% risky assets, 75k spend

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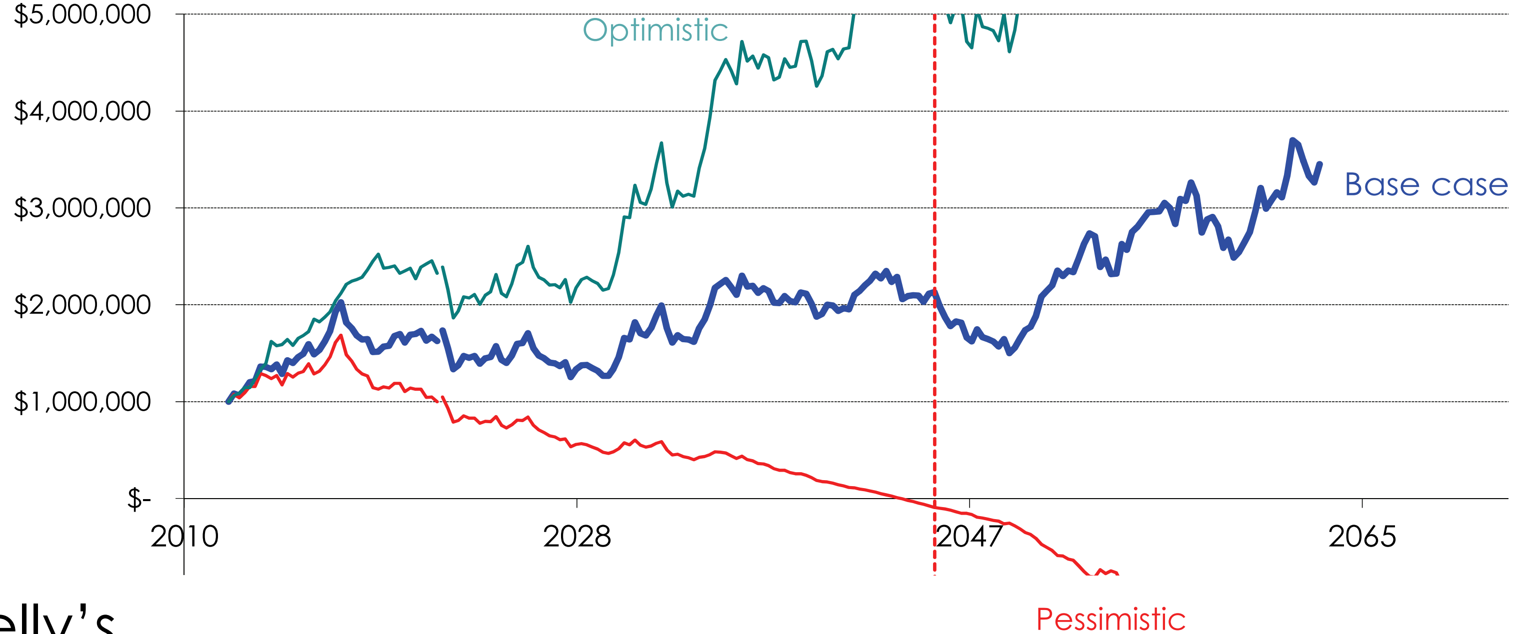
# Just has to spend less

Real capital balance over time, 70% risky assets, 75k spend.

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# Perhaps take less risk

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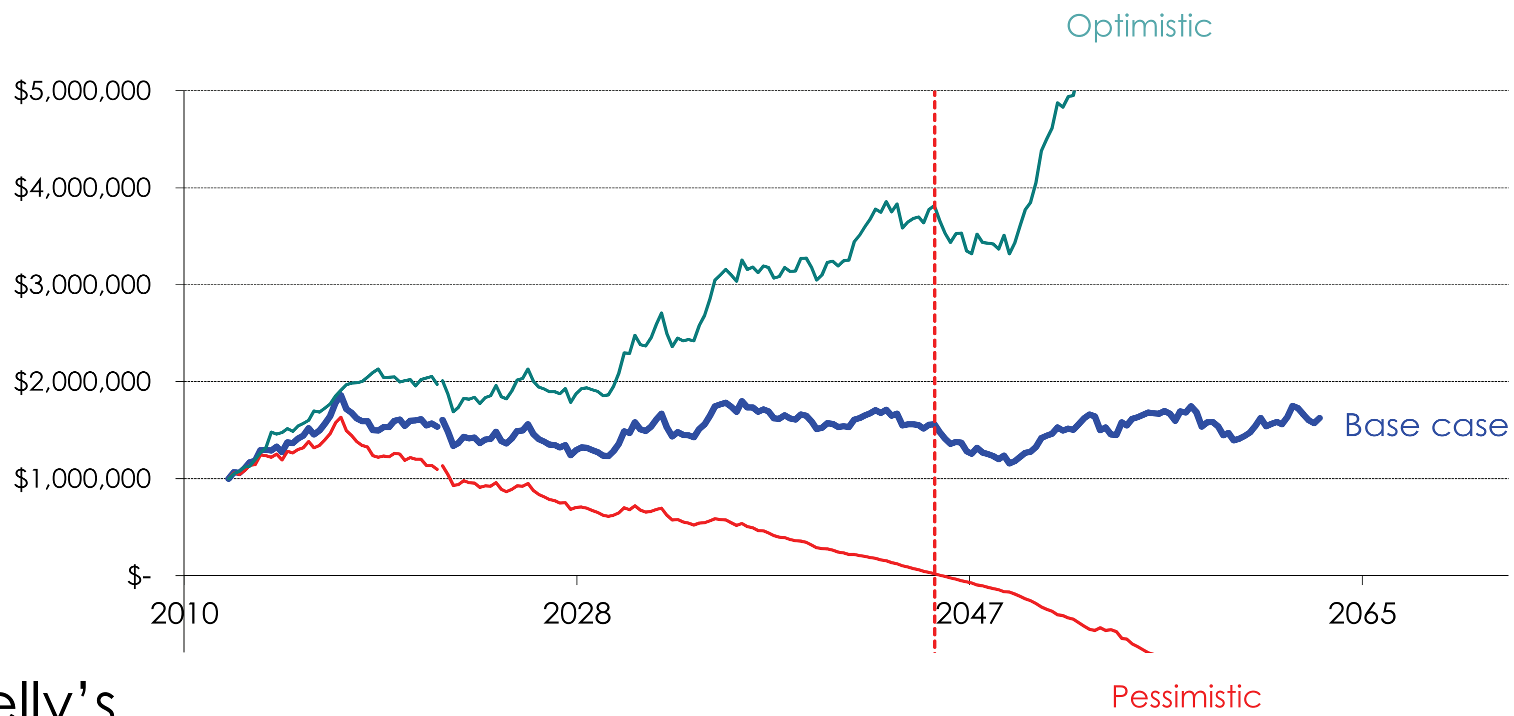
Real capital balance over time, 55% risky assets, 75k spend.

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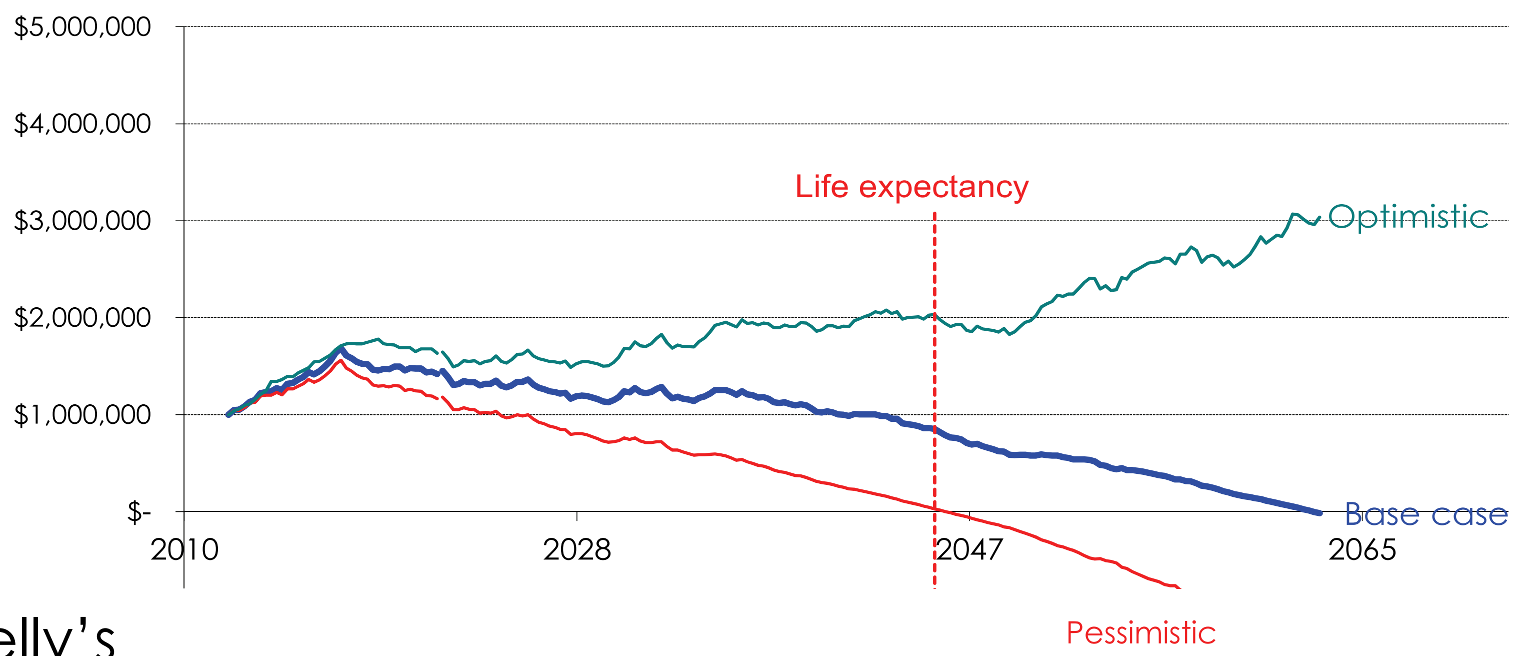
# Or much less risk…

Real capital balance over time, 30% risky assets, 75k spend.

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# What do we recommend?

- Attitude says 70% risky assets
- Capacity says 30 to 55% risky assets

# What will have to change with your processes?

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- Risk profiling?
- Risk management?

# What tools do you need?

- Psychological risk profiling?
- Risk capacity measurement?
- Investment research?

# Maximising returns or minimising risk?

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- Lifecycle investing is about maximising chance of success
- Risk profiling is a critical part of the planning process
- Risk profiling should be sensible, client friendly and defensible
- New processes and tools are needed

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# Lifecycle Investing

Accumulation
Decumulation